No. 10274

7

IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

SEATTLE RENTON LUMBER COMPANY, a corporation, *Appellant,*

vs.

UNITED STATES OF AMERICA, *Appellee.*

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

WETER, ROBERTS & SHEFELMAN,
Attorneys for Appellant.

1612 Northern Life Tower,
Seattle, Washington.

THE ARGUS PRESS, SEATTLE

No. 10274

IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

SEATTLE RENTON LUMBER COMPANY, a corporation, *Appellant,*

vs.

UNITED STATES OF AMERICA, *Appellee.*

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

WETER, ROBERTS & SHEFELMAN,
Attorneys for Appellant.

1612 Northern Life Tower,
Seattle, Washington.

THE ARGUS PRESS, SEATTLE

INDEX

TABLE OF CASES

TEXTBOOKS

STATUTES

[*Italics, wherever used in this brief, are ours*]

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

SEATTLE RENTON LUMBER COMPANY, a corporation, *Appellant*,

vs.

UNITED STATES OF AMERICA, *Appellee*.

No. 10274

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

STATEMENT OF JURISDICTIONAL FACTS

This action was instituted in the District Court of the United States for the Western District of Washington, Northern Division, by the Seattle Renton Lumber Company, a Washington corporation, in March, 1938, to recover from the United States of America certain income and excess profits taxes in the sum of $4023.37 paid for the taxable year 1933 (R. 2-10). Notice of deficiency was given appellant on January 10, 1936, and on May 11, 1936, the tax assessed was paid under protest (R.3). On November 6, 1936, appellant filed claims for refund with the

Collector of Internal Revenue (R. 4) which were disallowed by the Commissioner on April 9, 1937 (R. 9).

Alex McK. Vierhus, the Collector of Internal Revenue to whom payment of the taxes was made, ceased to serve in that capacity prior to the commencement of this action (R. 10).

All of the foregoing facts were set forth in appellant's petition (R. 2-10) and were admitted in appellee's answer (R. 11-13).

This action was instituted against the United States of America in the District Court under authority of the Judicial Code of the United States, 28 U.S.C.A. Sec. 41, sub-sec. 20.

The case came on for trial before the Honorable E. E. Cushman, Judge of the United States District Court, sitting without a jury, on January 23, 1939. He took the matter under advisement, but before rendering any decision retired because of ill health (R. 19). On stipulation of counsel (R. 16) the matter was submitted to the Honorable Lloyd L. Black, Judge of the United States District Court, for decision upon the transcript of the evidence without further testimony. After argument, Judge Black rendered his oral decision on March 15, 1941, wherein he ruled that appellant's petition should be dismissed (R. 27). Findings of Fact, Conclusions of Law and final Judgment dismissing appellant's petition were thereafter made and entered by Judge Black on August 20, 1941 (R. 37-43). On August 27, 1941, appellant served and filed its motion for new trial (R. 34) which was entertained and considered by the court and by order denied on the 13th day of July, 1942 (R. 35). On Sep-

tember 5, 1942, appellant filed its notice of appeal and a proper bond (R. 43). On September 8, 1942, a stipulation of the matters to be included in the record on appeal addressed to the Clerk of the District Court was filed (R. 45). The said record was filed in this court on October 5, 1942, and the case docketed on October 12, 1942 (R. 177).

Jurisdiction for this appeal in the Circuit Court of Appeals is claimed under authority of the Judicial Code, 28 U.S.C.A., Secs. 225 (Supp.) and 226.

STATEMENT OF THE CASE

The appellant, Seattle Renton Lumber Company, a Washington corporation, instituted this action in the United States District Court against the United States of America to recover the sum of $4023.37 representing income and excess profits taxes and interest thereon paid by it pursuant to a notice of deficiency issued by the Collector of Internal Revenue. Appellant asserted that the taxes were erroneously assessed. It alleged in its petition that it was a Washington corporation doing business in Seattle and that it made an income tax return for the year 1933 showing income of $3571.15 on which it paid income tax of $491.03 but no excess profits tax (R. 2); that on July 1, 1933, it sold its plant and inventories to a partnership which thereafter operated the business formerly owned by the appellant, the members of the partnership reporting the income from the business after July 1, 1933, in their individual tax returns (R. 3); that thereafter the Income Tax Department ruled that the

income earned by the business subsequent to July 1, 1933, was income of the corporation and that the corporate income should be increased by $19,618.10, which action by the Department was protested by the corporation to the Commissioner of Internal Revenue, but the protest was overruled (R. 3) and notice of deficiency was given to appellant; that pursuant thereto appellant made the additional payments of income and excess profits taxes, for the recovery of which this action was instituted; and that subsequent to the payment of the taxes, appellant regularly filed its claims for refund which were rejected by the Commissioner of Internal Revenue (R. 4-10).

In answer to appellant's petition the United States of America answered admitting essentially all of the allegations of appellant's petition except it denied that the income from the operation of the business subsequent to July 1, 1933, belonged to a partnership, but alleged that the income in fact belonged to the corporation (R. 11, 12).

The sole issue raised by the pleadings and for the determination of which this appeal is prosecuted is whether or not appellant received the income from the operation of the lumber mill subsequent to July 1, 1933. It is appellant's position that on that date the corporation transferred all of its operating property and inventories to its shareholders who thereafter operated the business as a partnership under the name, Seattle Renton Mill Co. Appellee contends the transfer was not accomplished. Appellee called no witnesses at the trial. Various witnesses

testified on behalf of appellant and their testimony is uncontradicted.

The evidence is essentially as follows:

The Seattle Renton Lumber Company was incorporated under the laws of the State of Washington in 1929 after which it built a sawmill and was continuously engaged in the manufacture and sale of lumber until the last day of June, 1933. The stockholders of the corporation were, with the exception of James C. Carlson and certain members of his family and James P. Weter, relatives of F. M. Roberts by blood or marriage (R. 51). James P. Weter was a law partner of F. M. Roberts, having been associated with him since 1904 (R. 51). James C. Carlson had been a business associate of F. M. Roberts for many years (R. 61). In the spring of 1933 F. M. Roberts, who was the Secretary and Treasurer and one of the members of the Board of Trustees of appellant (R. 50), discussed with all of the shareholders except the wife and two children of James C. Carlson (the stock in their names being in fact owned by James C. Carlson (R. 136)), the matter of transferring the mill business to a partnership on June 30th next (R. 53), at which time the corporation ordinarily took inventory and made its semi-annual profit and loss statement (R. 57). The purpose was admittedly to reduce income taxes (R. 53). The matter was approved by all said stockholders (R. 53).

F. M. Roberts, James C. Carlson and Mr. Dougherty, who was the mill bookkeeper, took steps to get the books in shape so that the transfer could be accomplished on the last day of June, 1933 (R. 57). On

June 15, 1933, due and regular notice of a special meeting of the shareholders of the corporation to pass upon the sale of the assets of the corporation to the partnership was given (R. 59). Pursuant to the notice a stockholders meeting was held on June 30, 1933, at which the action of the Board of Trustees, taken earlier that day, selling all of the corporate assets except the accounts receivable to a partnership composed of the shareholders was approved (R. 67). On the same day appellant Seattle Renton Lumber Company by its officers executed and delivered a deed to all its real property to F. M. Roberts (R. 69), who concurrently executed a declaration of trust reciting that he held the property in trust for the partners, doing business as Seattle Renton Mill Co., naming them and designating their respective interests (R. 76-78). At the same time appellant also executed a bill of sale of all its personal property to the Seattle Renton Mill Co., a partnership (R. 73).

After June 30, 1933, separate records were kept for the said partnership (R. 112) which operated thereafter under the name of the Seattle Renton Mill Co. New bank accounts were opened for the partnership (R. 95) and the business was in fact operated as a partnership. The signs on the mill water tower, motor trucks and automobile were changed to show the new name (R. 98). The old stationery, bill forms, checks, etc., were changed by pencil or by rubber stamp until the existing supply ran out when new supplies were procured and printed with the name of the partnership thereon (R. 102, 148, 150, 157, 158-161, 117-123). In the following March the income

from the operation of the business from June 30 to December 31 was reported by the partners in their individual income tax returns in proportion to their interest in the partnership.

There is no evidence that any business was transacted by appellant corporation subsequent to June 30, 1933, except that the United States introduced in evidence a check (R. 126) whereon the words "President" and "Treasurer" were printed below the signature line under the name "Seattle-Renton Mill Co." However, from July 1, 1933, to November of that year blank checks only were used on which the name "Seattle Renton Mill Co." was placed (R. 148, 150, 157-161). In November a new supply was ordered and, by mistake on the part of the check salesman, the words "President" and "Treasurer" appeared on the checks (R. 134, 139-144-146). The check order was large and the mill manager decided to keep the checks rather than require that they be made over (R. 134). It is also interesting to note that practically all of the checks were signed by Mr. Dougherty who was the bookkeeper for the partnership, and originally for the corporation. He was never an officer in appellant corporation (R. 139, 152).

There were no written Articles of Copartnership. The parties interested in appellant and in the partnership were closely related either by blood, marriage or business ties and many of them had been associated together as partners over a long period of years. In no case had they ever had written Articles of Copartnership (R. 55-57). The deed by which the real property was transferred, the declaration of trust and

the bill of sale transferring the personal property to the partnership were not recorded, nor was a certificate of assumed name filed. These facts are wholly negative in character and, as will be pointed out, have no legal effect on the validity of the transactions. Yet they were the principal basis for the conclusion of the Bureau of Internal Revenue that no partnership existed.

SPECIFICATIONS OF ERROR

1. The United States District Court for the Western District of Washington, Northern Division, erred in making the findings contained in Paragraphs VI, VII, VIII, IX, and X of that Court's Findings of Fact (R. 37-40), wherein the court found that no partnership was formed by the stockholders of the appellant on June 30, 1933, or at any time before January 1, 1934; that the appellant operated its business on the same basis after June 30, 1933, as it did prior thereto; that income arising out of the operation of the business subsequent to June 30, 1933, was income of the appellant; that appellant failed to satisfy the requirements of the burden of proof, and that the record showed no overpayment of tax. These findings were erroneous in that there was insufficiency of the evidence to justify such findings since no evidence was adduced that the appellant engaged in business or received income so as to subject it to a tax after June 30, 1933, but to the contrary, all of the evidence introduced clearly established that a partnership was formed on June 30, 1933, which thereafter owned and operated the business, and that appellant did not engage in any business nor receive any income so as to

subject it to a tax after June 30, 1933, and the court should have made findings of fact to the effect that such a partnership was formed on June 30, 1933, and that appellant did not engage in any business nor receive any income so as to subject it to a tax thereafter.

2. The District Court further erred in entering its Conclusions of Law (R. 40) and Judgment (R. 42) because of the insufficiency of the evidence, as hereinbefore stated, to justify the findings of the court, and the court should have entered its Findings of Fact, Conclusions of Law and Judgment to the effect that a partnership was formed on June 30, 1933, which thereafter owned and operated the business; that appellant did not engage in any business nor receive any income so as to subject it to tax after June 30, 1933; and that appellant should recover judgment against the appellee for the sum of the taxes paid herein by appellant pursuant to the notice of deficiency given by the Collector of Internal Revenue.

SUMMARY

The appellant did not earn any income after June 30, 1933, for on that day it effectively divested itself of ownership, control and management of the mill business it had formerly operated. This fact, which was clearly established, in itself warrants reversal of the trial court which in effect found that the appellant earned income after that date. In addition to this, the evidence conclusively showed that a partnership came into existence and operated the business after June 30, 1933. This evidence shows the intent to create a partnership on the part of the persons who were

the shareholders of appellant and assent by the shareholders to the transfer of the mill business to the partnership by the managing officers, and to the conduct of the business as a partnership. The uncontroverted evidence adduced by appellant fully satisfied the requirements laid down by the United States Board of Tax Appeals in various cases as to what proof is necessary to show the change of operation of the business from a corporation to a partnership composed of the shareholders. The District Court erroneously concluded that appellant corporation itself owned, controlled and operated the mill business after June 30, 1933, and was subject to taxation on the income therefrom after that date—a conclusion wholly unsupported by the evidence.

ARGUMENT OF THE CASE

PREFACE

This case comes before the Circuit Court of Appeals on an uncontradicted record. It was tried before Judge Cushman sitting without a jury (R. 19) and was thereafter submitted for decision to Judge Black on the written record. He had no opportunity to hear the witnesses nor observe their demeanor on the witness stand. Since it has been held in the case of *Monroe Sand & Gravel Co. v. Sanders*, 79 F.(2d) 292, that the Circuit Court of Appeals is not limited by the trial court's findings and conclusions where the evidence is uncontradicted and where a jury has been waived, and since, in this case, this court has as good an opportunity to determine the weight of the testimony as had the trial court, we have taken the liberty of discussing the evidence in the case at some length.

ARGUMENT

A. The fact that the motive of appellant's shareholders was to minimize taxes does not invalidate their action if it is otherwise lawful.

It was candidly admitted at the trial that the purpose of the transfer of the assets of appellant corporation to a partnership was to reduce taxes. This, however, is immaterial, for such a motive or purpose does not invalidate the action taken so long as it was lawfully accomplished. There is abundant authority for this position. Judge Learned Hand stated the rule in *Helvering v. Gregory*, 69 F.(2d) 809 (1934):

> "We agree with the Board and the taxpayer that a transaction, otherwise within an exception of the tax law, does not lose its immunity because it is actuated by a desire to avoid, or, if one choose to evade, taxation. Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." Citing, *U. S. v. Isham*, 17 Wall. 496, 506, 21 L. ed. 728; *Bullen v. Wisconsin*, 240 U.S. 625, 630; 36 Sup. Ct. 473; 60 L. ed. 830.

This case was affirmed by the Supreme Court of the United States on appeal in 293 U.S. 465, 55 Sup. Ct. 266, 79 L. ed. 596. The Supreme Court, speaking through Mr. Justice Sutherland, said:

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

The Ninth Circuit Court of Appeals is in accord

with this rule. In *Commissioner of Internal Revenue v. Eldridge*, 79 F.(2d) 629, 631, this court said:

> "It is argued by the Commissioner that the transfers by respondents to the corporation were made for the purpose of establishing a deductible loss for income tax purposes. This, if true, is unimprotant. A taxpayer may resort to any legal method available to him to diminish the amount of his tax liability." Citing *Gregory v. Helvering, supra; Superior Oil Co. v. Mississippi*, 280 U.S. 390, 395, 50 Sup. Ct. 169, 74 L. ed. 504; *Bullen v. Wisconsin*, 240 U.S. 625, 630, 36 Sup. Ct. 473, 60 L. ed 830; *Jones v. Helvering*, 63 App. D. C. 204, 71 F.(2d) 214, 217.

In *Weeks v. Sibley*, 269 Fed. 155, where it was stated that the sole and compelling motive for the transfer of the assets of a company to a trustee was to minimize taxation, the court said:

> "Bearing in mind the rule of construction which the Supreme Court announced in the case of *Gould v. Gould*, 245 U.S. 151, 38 Sup. Ct. 53, 62 Law Ed. 21, and numerous other cases, to the effect that the provisions of the taxing statutes are not to be extended by implication beyond the clear import of the language used, and that they are to be construed most strongly against the government and in favor of the taxpayer, *it is the opinion of this court that the right to change the status of an organization or to dissolve an organization, in any legal manner, is not made ineffectual because the motive impelling the change is to reduce or avoid taxation in the future.* The right so to do is an incidental right inseparably connected with an individual's right to own and control his property * * *.

"It is not unnatural that any thoughtful business man may take such steps."

Since the motive behind the appellant's transactions in this case is immaterial, the sole and controlling issue for this court's determination is whether or not the appellant earned income subsequent to June 30, 1933. In determining this, the primary question is whether the corporation as a legal entity owned and operated the mill business and was entitled to the income therefrom after June 30, 1933. Thus, whether a partnership was created becomes important, for if a partnership operated the business, of course the corporation did not. However, the issue is not, as was apparently assumed by the trial court (R. 26), whether the partnership existed, but whether appellant received income after June 30, 1933. If appellant divested itself of ownership, and ceased to operate the business on that date, it does not matter whether the owners of the business operated it thereafter under an agreement or not, for it would make no difference to this case whether they were tenants in common with no agreement or whether they operated as partners.

B. The corporation did not own the mill property and business, nor receive income therefrom after June 30, 1933.

The trial court in its opinion and in its findings of fact, conclusions of law and judgment found that appellant corporation owned and operated the mill business and received income therefrom after June 30,

1933 (R. 37-42). We submit, however, that this conclusion is not supported by the evidence.

After meetings duly and lawfully held by the Trustees (R. 62) and by the shareholders (R. 67) the officers of appellant corporation were authorized to and did transfer all of its real property to F. M. Roberts by deed (R. 69). Concurrently, he executed a declaration of trust wherein he recited that he held the property in trust for the persons who were shareholders in the corporation, their interests being in proportion to their stock holdings (R. 76). At the same time the corporation transferred all of its personal property, except its accounts receivable, to the Seattle-Renton Mill Co., a partnership (R. 73). The accounts receivable were retained for two reasons: First, to meet the outstanding accounts payable of the corporation (R. 65) and second, to avoid any criticism by the Bureau of Internal Revenue with regard to gains or losses which might arise with respect to certain of the accounts which were of doubtful value (R. 66), appellant's officers feeling that such gains or losses should be returned by the corporation (R. 66).

After the transfer of the business was accomplished, the property and business which had formerly been operated by appellant were either owned outright by the persons who were shareholders in appellant, or held in trust for their benefit. Thereafter the corporation kept no records of the mill business and, in fact, did not operate it. This in itself would show that whatever income was earned from the business subsequent to June 30, 1933, was not income of appellant, whether a partnership was formed or not.

Operation of the business by some of the tenants in common would, of course, not be improper, and any suggestion that the corporation as such was operating the business subsequent to June 30, 1933, can be based only on inference and innuendo, there being no evidence whatsoever that it was so doing.

C. Operation of the business by a partnership after June 30, 1933, is conclusively shown by the evidence.

As has been pointed out, in the trial below, appellee insisted that no partnership was created because the deed, declaration of trust and bill of sale whereby the business was transferred to the partnership were not recorded; written Articles of Partnership were not executed, and a certificate of assumed business name was not filed. The trial court was of the opinion that no formal contract of partnership was established. None of these objections are significant for, under Washington law which of course controls the nature of the relationships here involved, the existence of a partnership is determined by the intention of the parties and not by the facts just mentioned.

Partnerships may be created by informal unwritten agreements or understandings and the intention to create a partnership may be shown merely by the conduct of the parties. This is true both in suits between partners and third persons and in suits between partners themselves. One of the latest statements of the Supreme Court of the State of Washington on this matter is found in the case of *Stipcich v. Marinovich*, 113 Wash. Dec. 24, at p. 27; 124 P.(2d) 215:

"The principal question to be decided is wheth-

er there was a partnership. In deciding that proposition it is necessary to mention some rules which must be applied. We have said:

" 'The essential test in determining the partnership relation, is whether the parties intended to establish such a relation; and that, as between themselves, this intention is to be determined by their express agreement, or inferred from their acts and conduct. *Causten v. Barnette*, 49 Wash. 659, 96 Pac. 225.' *Yatsuyanagi v. Shimamura*, 59 Wash. 24, 109 Pac. 282.

" 'There is no arbitrary rule by which it may be determined whether a partnership relation existed in a given instance or not. The existence of a partnership depends upon the intention of the parties. That intention must be ascertained from all of the facts and circumstances and the actions and conduct of the parties * * *. It is well settled that no one fact or circumstance will be taken as the conclusive test. Where, from all the competent evidence, it appears that the parties have entered into a business relation combining their property, labor, skill and experience, or some of these elements on the one side and some on the other, for the purpose of joint profits, a partnership will be deemed established.' *Nicholson v. Kilbury*, 83 Wash. 196, 145 Pac. 189.

" 'The question of partnership depends upon the intent of the parties as manifested by their conduct, statements, and written contracts. Generally speaking, if such contracts, statements, and conduct establish an intent, and prove a common venture uniting the labor, skill, or property of the parties for the purpose of engaging in lawful commerce or business for the benefit of

all of them, and an agreement to share profits and losses, a partnership is formed. (Citing cases).' *Constanti v. Barovic*, 199 Wash. 117, 90 P.(2d) 724.

"See, *Purdy & Whitfield v. Department of Labor & Industries*, 111 Wash. Dec. 658, 120 P. (2d) 858.

"As observed from our decisions, the test to be employed in ascertaining the existence of the partnership relation is the intention of the parties to be partners. Intention, in turn, is found in their express agreements, statements, and conduct."

The leading case on the requisites of a partnership in this state is *Nicholson v. Kilbury*, 83 Wash. 196, 145 Pac. 189, at p. 201:

" * * * There is no arbitrary rule by which it may be determined whether a partnership relation existed in a given instance or not. The existence of a partnership depends upon the intention of the parties. That intention must be ascertained from all of the facts and circumstances and the actions and conduct of the parties. While a contract of partnership, either expressed or implied, is essential to the creation of the partnership relation, it is not necessary that the contract be established by direct evidence. The existence of the partnership may be implied from circumstances, and this is especially true where, as here, the evidence touching the inception of the business and the conduct of the parties throughout its operation, not only tends to show a joint or common venture, but is in the main inconsistent with any other theory."

The above case is quoted at length by the Supreme

Court of the State of Washington in the case of *Constanti v. Barovic*, 199 Wash. 117, 90 P.(2d) 724, at page 126.

The foregoing cases involved actions between partners. The Supreme Court of the State of Washington has adopted the identical rule in suits between third persons and partners, but in fact requires less proof to establish a partnership where the controversy is between others than the partners themselves, as in the instant case. Thus, in *Collyer v. Egbert*, 200 Wash. 342, 93 P.(2d) 399, in which a creditor sought to recover from partners as such, the court quoted from the cases of *Barovic c. Constanti*, 183 Wash. 60, 48 P. (2d) 257, and *Nicholson v. Kilbury*, 83 Wash. 196, 145 Pac. 189, using from the latter case the same quotation we have set forth above. In *Purdy & Whitfield v. Department of Labor & Industries*, 12 Wn.(2d) 131, 120 P.(2d) 1002, the same quotation was used as stating the applicable rule in determining whether a deceased person was a partner or an employee under the state workman's compensation law.

With regard to the proof required to show a partnership in such cases, the Supreme Court of Washington in *Cruickshank v. Lich*, 158 Wash. 523 at 531, 291 Pac. 485, said:

> "As to third persons, less proof is required to show a partnership than as between the parties themselves."

For the formality necessary to create a partnership agreement, reference is made to the case of *Roediger v. Reid*, 133 Wash. 608, 234 Pac. 452. In that case there was no evidence whatsoever that a contract of partnership had ever been made. In the suit for an accounting

of the partnership property, the court, at page 610, says:

> "The question then arises whether a partnership did in fact exist. For the purpose of establishing a partnership, of course, it is a matter of common understanding that no formal contract is necessary. Such a partnership may be made by oral or written agreement, and may result from the acts or conduct of the parties."

Will v. Domer, 134 Wash. 576, 236 Pac. 104, was also a case involving an accounting between partners. In determining whether a partnership existed, the court stated on page 579 as follows:

> "They first contend that the testimony fails to show the existence of a partnership for farming and fruit purposes. On this question suffice it to say that a reading of the testimony and the contract heretofore mentioned convinces us that a partnership existed, Domer and wife having an undivided one-half interest therein, the plaintiffs having an undivided one-third interest, and Smith and wife an undivided one-sixth interest. It is true that there is no express provision either in the contract or in the oral testimony to the effect that it was the intention of the parties to form a partnership. But a partnership may arise out of the conduct of the parties, provided it can be determined therefrom that such was the intention, and that it was the intention in this instance that there should be a partnership in the operation of this land, we have no doubt."

In *Causten v. Barnette*, 49 Wash. 659, 96 Pac. 225, (an accounting suit) the court stated at page 664:

> " * * * and where, as in this case, an accounting and equitable relief are sought by one who was a

> party to the written agreement and who asserts that the same was intended to be, and was, a partnership agreement, it is permissible for the court to receive evidence as to how the parties themselves have construed the written contract as to whether the one disputing the alleged partnership has heretofore treated it as a partnership agreement."

From the foregoing cases, it appears that the rule in Washington is that intention to create a partnership is a primary essential for its existence, and that such intention or the actual existence of the partnership may be shown by the acts and conduct of the parties, and by the interpretation of the parties. The cases furthermore demonstrate that the agreement of partnership may be made most informally. We submit that the facts which we have heretofore discussed, and to which we shall make further reference, conclusively show that the parties having an interest in the appellant corporation intended to and did create a partnership which took over the business of appellant and operated it after June 30, 1933.

The fact that the deed and declaration of trust were never recorded does not defeat their operation, for such instruments are valid, though unrecorded. In 23 R.C.L. 230, Sec. 95, the rule is stated thus:

> "At common law, recording was not necessary to the validity of the deed, or to make it effective against all subsequent conveyances; and such is the law now, except so far as the recording acts have expressly, or by necessary implication, limited their effect and operation. *The registry of a deed adds nothing to its effectiveness as a con-*

veyance; all that it accomplishes is to impart notice; and it is a rule of universal application that an unrecorded deed, mortgage or other instrument affecting the title to land is valid as between the parties thereto, and their heirs, and those claiming under the grantee and against everyone else who is not within the protection of the recording acts."

The Washington Recording Act, Rem. Rev. Stat. of Washington, Section 10596-2, does not require such instruments to be recorded. It provides:

> "Sec. 10596-2. *Conveyances recorded.* A conveyance of real property, when acknowledged by the person executing the same (the acknowledgement being certified as required by law), *may* be recorded in the office of the recording officer of the county where the property is situated. Every such conveyance not so recorded is void as against any subsequent purchaser or mortgagee in good faith and for a valuable consideration from the same vendor, his heirs or devisees, of the same real property or any portion thereof whose conveyance is first duly recorded. An instrument is deemed recorded the minute it is filed for record. * * * "

Needless to say, there is not involved here the right of a subsequent purchaser or mortgagee. The validity of the conveyance in this case is unaffected by this statute.

Similarly the failure to file a certificate of assumed business name has no bearing on the existence of the partnership, it being merely a condition precedent to a suit by the partnership.

In *Powelson v. Seattle,* 87 Wash. 617, 162 Pac. 329, where, at pages 619 and 620 the court said:

> "When the injury occurred, no Certificate of Assumed Business Name had been filed by the Seaport Construction Company. Prior to the commencement of the action, however, a proper certificate had been filed. *The filing of the certificate was not necessary to give a legal existence to the partnership; it was merely a condition precedent to the right to sue and a filing prior to the commencement of the action was sufficient.*"

The cases of *Sutton & Co. v. Coast Trading Co.,* 49 Wash. 694, 96 Pac. 428, and *Union Trust Co. v. Quigley,* 145 Wash. 176, 259 Pac. 28, are in accord with the above rule.

Returning to the evidence in this case, the intention to form a partnership is shown by the acts and conduct of the parties and by their own interpretation. We submit that the evidence in fact shows the agreement itself. Referring to the record, we find at page 53 the following testimony by F. M. Roberts:

> "Q Now, you speak of this happening on the 30th day of June, 1933. Had there been any discussion of this change from a corporation to a partnership or sale of the assets prior to that date?
>
> A Yes, the discussion of that began—I couldn't give the date, but in the spring of 1933." (R.53)

And later on the same page we find the following:

> "Q You say that discussion started early in 1933. With whom was that matter discussed?
>
> A It was discussed with all of the stockholders who were of age. It was discussed by me

with all of them, except Mr. Carlson's wife and his two children.* We had no formal corporate meetings at which it was discussed, but we were frequently together in groups or I with individuals of the corporation, and I discussed it with them, the purpose of it, and it met with the approval of all of the stockholders." (R.53)

And again on page 57 of the record, we find the following:

"Q What preparations were made by the corporation officers prior to June 30, 1933, preparatory to actually making the transfer to the partnership?

A As I said before, we had discussed the matter; *it met with the approval of all the people interested,* and I then instructed—for instance, Mr. Dougherty, the bookkeeper at the mill, and Mr. Carlson, the manager, informed them of our intent to make this arrangement and asked that they get the books in shape so that we could accomplish this purpose on the last day of June." (R. 57).

On June 15, 1933, a notice was sent to each of the stockholders notifying them that there would be a special meeting of the stockholders of the corporation "to pass upon the question of the sale of the assets of the corporation to a partnership to be formed to take over the same" (R. 59). On page 62 of the record we

---

*NOTE: Mr. Carlson's wife and children were not in fact the owners of the shares in their names. These shares were owned by Mr. Carlson. See R. 136.

find the minutes of a trustees' meeting held June 30, 1933, in which we find the following:

> "After a discussion of this statement (financial statement), it was the opinion of the trustees that the corporation should go out of business, and that the mill and business should be taken over by a partnership composed of the present stockholders." (R.62)

The minutes then recite that a resolution was presented, a portion of which is quoted as follows:

> "Resolved, that the Seattle Renton Lumber Company sell to a partnership which will be composed of the same persons who have held stock in the Seattle Renton Lumber Company, and which will be known as the Seattle Renton Mill Co."
>
> " * * * and that the offer of the said partnership to purchase upon the said terms and to assume the mortgage upon the mill plant in the sum of Twenty Thousand Dollars be accepted, and that the President and Secretary of the corporation be authorized to do whatever acts are necessary to complete the said sale." (R.63)

From the minutes of the stockholders' meeting held on the same day, we find the following:

> "The Secretary then read to the stockholders the minutes of a meeting of the Trustees which had just been held, said minutes setting forth a resolution of the Trustees under which the real estate and all tangible personal property of the mill, a corporation, was to be sold to a partnership composed of the stockholders in the mill, the partners to contribute to the new partnership the dividends received from the mill. After reading the said minutes, it was moved, seconded and

carried that the action of the Trustees in selling the mill property and in the declaration of a dividend be approved. The same received the unanimous vote of all stock represented at the meeting." (R.68)

In the bill of sale from the Seattle Renton Lumber Company executed on June 30, 1933 (R. 73), we find that the vendee therein was the "Seattle Renton Mill Co., a partnership." In the declaration of trust executed by F. M. Roberts (R. 76) we find a list of the persons who were formerly shareholders in the corporation, and we find in the statement made:

> "I further declare that I have taken said title at the request of the persons interested in said real estate, *who are partners as the Seattle Renton Mill Co.*" (Italics our own). (R. 78).

As shown from this evidence and from their subsequent conduct, the parties intended a partnership as of the date the mill business was transferred from the corporation. The trial court in its oral decision seemed to feel that the agreement was merely that a partnership would come into existence at some future date. We believe, however, that a more logical interpretation is that the parties intended the partnership to begin functioning as of the date when they all contemplated that the business would be transferred to it.

Although the trial court was of the opinion that there was no executed contract of partnership, there was no question but that the various shareholders knew of the contemplated change in the operation of the business from a corporation to a partnership. This, in itself, arguably is all that is necessary to bind

them as shareholders. In *Robinson v. First National Bank of Marietta* (Supreme Court of Texas) 98 Tex. 184, 82 S.W. 505, the court was of the opinion that whether or not shareholders would be bound as partners where the business was operated as a partnership depended upon the knowledge and assent of the shareholders. At page 507 of the Southwestern Reporter the court stated the rule as follows:

> "On the other hand, if the stockholders of the corporation agreed to cease doing business as a corporation, and to carry it on as a partnership under the name of Saxon, Pierce & Co., all would be bound for the debt."

The case of *Quick v. Pevehouse* (Texas) 41 S.W. (2d) 635, seems to go a little further and hold that knowledge of the shareholder is all that is necessary to bind him where the corporate business is subsequently operated by a partnership. In that case the shareholders of Lubbock Grain & Feed Co., a corporation, continued to do business but used the name of Yellow House Mills. While they were so doing the plaintiff sold certain goods to the Yellow House Mills and thereafter instituted this action to recover from the shareholders on the theory that they were operaing a partnership under that name. The evidence was uncontradicted that the original corporation had never been dissolved and it showed that the defendants owned all the stock therein. The court said that it felt that the case of *Robinson v. First National Bank of Marietta*, 98 Tex. 184, 82 S.W. 505, was authority for judgment against Dickinson, one of the defendants.

From the following quotation it appears that share-

holder Dickinson was bound as a partner because the corporate business was being operated as a partnership simply because he had knowledge of how the business was being conducted and made no objection to it:

> "According to the testimony of Dickinson, a similar condition exists in the instant case. The old corporation had not been dissolved, but the three original stockholders were trying to wind it up and pay off its debts in order to avoid bankruptcy. They were keeping its business transactions and its bank account separate from the new company. The new company was being operated in a rather unusual manner, in that its funds were deposited to the individual account of Quick and its checks drawn in the name of Yellow House Mills were, it seems, paid out of that account. *If Dickinson, Sr. had no knowledge of how the business was being conducted, he would have occupied the position of Robinson and Hoskins in the Robinson case; but he says he was the president of the old corporation and knew how the account of the Yellow House Mills was being handled.* According to his testimony, the Yellow House Mills was, in law, a partnership and under the general rule that each partner is an agent of the firm, authorized to represent it in the business for which it was organized, judgment was properly rendered against Dickinson."

We submit that there can be absolutely no question in this case but that all the persons who owned stock in the appellant corporation knew of the transfer of the business from the appellant corporation to the partnership and made no objection to it.

D. Appellant adduced sufficient evidence under the rules laid down by the Board of Tax Appeals for income tax cases to show that the mill business had been transferred to a partnership.

It is not surprising that the transfer of a business from a corporation to a partnership is often resorted to in order to reduce income taxation. The average individual engaged in business will carefully balance the value of the limited liability afforded by a corporation with its cost in the form of taxation. When the taxes increase beyond a given point it will be found advantageous to abandon the corporate organization and operate the business as a partnership. The Board of Tax Appeals has on three occasions considered this type of transfer and has indicated the type of evidence necessary to show that the change in organization has been accomplished. The earliest case is that of *Rice-Sturtevant Automobile Company v. Commissioner of Internal Revenue*, 6 B.T.A. 793. In that case the corporation executed a bill of sale to the sole owners of the corporation giving them the right to use the corporate name and conduct the business. Thereafter the business was operated exactly as before with no notice given to any person of the purported change. Thhe Board noted that the sole issue in the case was whether or not the partnership was formed on a certain day and held the evidence insufficient, saying as follows:

> "No books of account of the partnership or of the corporation were produced, no part of the record of the bank in which it is claimed that two separate accounts were kept was produced, none of the cancelled checks of the so-called part-

nership were produced, none of its letterheads or of the letters sent out by it were produced, nor is the absence of any evidence of such a collateral nature which might have supported the contention of the petitioner excused in any way.

"The record is not convincing that there was in fact any *bona fide* delivery of the bill of sale which was executed on July 31, 1919, or any *bona fide* transfer of the assets named, or that the business was in fact carried on by the partnership and not by the corporation."

By contrast, however, in our case we find that the name of the business under which the mill was operated was changed to Seattle-Renton *Mill* Co. (R. 52, 97, 98, 102), all interested persons were notified that the business had changed to a partnership (R. 151-152). The signs on the mill building and on its equipment were changed to show the name of the partnership (R. 98, 151). Separate accounts of the partnership and of the corporation were kept (R. 112, 152), separate bank accounts were opened (R. 95), and new signature cards were delivered to the bank (R. 97). Cancelled checks of the partnership were produced (R. 148, 150, 157-161), as well as its invoices, both of which showed the change in the name of the business as of July 1, 1933 (R. 119-123). Furthermore, contrary to the *Rice-Sturtevant* case, there is no question here but that there was a *bona fide* delivery of the bill of sale and deed, and, as was stated by the court in its oral opinion, it is apparent that there was a *bona fide* attempt by the persons interested in the said business to carry it on as a partnership rather than as a corporation (R. 34).

Again in *Hinz and Landt, Inc. v. Commissioner of*

Internal Revenue, 8 B.T.A. 375, certain shareholders of a close corporation, after a regular meeting of the shareholders, met and informally agreed that they would form a partnership to take over the corporate business on January 1, 1920. Nothing was done, however, until May 17, 1920, at which time an offer from the partners, who were the shareholders of the corporation, to purchase all of the corporation's assets was approved and a bill of sale was executed and delivered on that day transferring all of the assets of the corporation to the partnership. There was no question in this case but that after May 17, 1920, the income earned from the business belonged to the partnership. The question in the case was with regard to the income earned between January 1 and May 17. In discussing the case the Board said on page 378:

> "It may be conceded without discussion that, as suggested by the petitioner, no particular form of contract is necessary to the creation of a valid partnership, and that the contract may be oral or written. We may even concede for the purpose of this opinion that the several stockholders of the petitioner did at the informal meeting of September 25, 1920, and shortly thereafter enter into a valid partnership agreement, but the formation of the partnership was not of itself sufficient to vest it with title to the petitioner's assets, and whether it acquired the petitioner's business on January 1, 1920, or at at later date, is a question of fact to be determined from the evidence * * *. The evidence shows that during the period in question the business was conducted under the corporate name, all purchases were made in the name of the corpo-

> ration and were paid for with its checks duly signed by its Treasurer. The evidence further shows that as late as February 28, 1920, the Board of Directors contemplated an increase of the corporation's capital stock and actually called a stockholders' meeting for that purpose. * * * The petitioner continued after that date and until May 17, 1920, to hold the title thereto and to hold itself out to the world as the actual owner, and all of the circumstances surrounding the conduct of the business support the conclusion that it was, in fact, the owner, and the respondent properly taxed to it the income involved herein, and we so hold."

Apparently the objection to the transaction involved in the foregoing case was that there had actually been no transfer of legal title to the partnership prior to May 17, 1920, and that the corporation continued to hold meetings, to hold itself out to the world as a corporation, and to buy and sell goods in its own name. However, after the execution of the bill of sale of the property to the partnership, there was no question as to the taxability of the income to it. Quite contrary to that case, the Seattle Renton Mill Co. operated the mill in its own name, all purchases were made in its name, all checks were made out by it. It held itself out as being a partnership and, in fact, actually held title to the property. Furthermore, the corporation did nothing with respect to the business after June 30, 1933 (R. 100).

In *Royal Wetwash Laundry Inc. v. Commissioner of Internal Revenue*, 14 B.T.A. 470, Mr. and Mrs. Greenberg and Mr. and Mrs. Steinman owned all the stock in a corporation doing a laundry business. For

the purpose of reducing income taxation, the corporation, at a regular meeting, passed a resolution that the business be transferred to a partnership composed of Mrs. Greenberg and Mrs. Steinman. This resolution was passed on January 2, 1920. However, the bill of sale and lease of the building and equipment and the certificate of assumed name of the partnership were neither executed nor filed until May 31, 1921. In the meantime, Mr. Greenberg was manager and bookkeeper of both the corporation and the partnership and kept all accounts of both concerns in books which had been used by the corporation, and at the close of the year credited the partnership with the profits disclosed by the only profit and loss account that had been kept. In 1921, at the time of making income tax returns, he opened new books and thereafter kept the accounts separate. Yet the Board held that the income earned subsequent to January 1, 1920, belonged to the partnership, saying as follows:

> "The partnership agreement was executed on January 2, 1920. On the same date the petitioner, by appropriate corporate action, transferred its business and certain of its property to the partnership. The fact that no bill of sale was given at that time is not material since the transfer was complete and effective without being evidenced by such an instrument, which is no more than a record of the transaction already effected * * * Failure to file a certificate stating the true ownership of a business conducted under a trade name may have subjected the parties to penalties under the laws of Minnesota, but we fail to see that such negligence in any way affected either the transfer of the

> laundry business or the ownership, and the taxability of the income derived therefrom. As the Commissioner conceded that the partnership was effective on and after May 31, 1921, it is apparent that he refused to recognize its existence prior thereto solely because a bill of sale was given and the certificate of information was filed on that date. We are satisfied with the evidence that the partnership was effective at and and after January 2, 1920, and that the income here involved was its income."

It is submitted that all of the essential evidentiary facts called for in these three cases have been met in our own. In fact, none of the cases shows as strong a record as that presented here. The rule apparently adopted by the Board of Tax Appeals is that the income from a business is to be returned by that organization which is, in fact, operating it. That the mill business here involved was not operated by the appellant corporation is amply supported by the evidence.

CONCLUSION

This case is presented to the court on an uncontradicted record which shows acts, conduct, understanding and intention on the part of the persons who were shareholders of appellant to operate the business as a partnership. Under Washington law the existence of a partnership depends upon intention, as shown by those facts. The evidence shows that all of the operating equipment and inventory was transferred to the partnership from the corporation and there is no evidence whatever that appellant corporation earned

any income from the operation of the business subsequent to June 30, 1933. We submit that the conclusion of the District Court that appellant corporation did receive income from the operation of the business after June 30, 1933, as shown by that court's findings of fact, conclusions of law and judgment, is erroneous in that it is not supported by the evidence and is contrary to law.

We respectfully submit that the judgment of the trial court should be reversed.

WETER, ROBERTS & SHEFELMAN,
Attorneys for Appellant.